No. 13,039

United States Court of Appeals
For the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association, and EUGENE J. O'RILEY, as Trustee in Bankruptcy of the Estate of United Produce Company, a corporation, Bankrupt,

Appellants,

vs.

MERCHANDISE NATIONAL BANK OF CHICAGO, a national banking association,

Appellee.

REPLY BRIEF FOR APPELLANTS.

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REPLY BRIEF FOR APPELLANTS.

I. A BRIEF STATEMENT OF THE BASIC FACTS.

Despite our efforts to deal concisely with the many complex questions of law and fact and the numerous arguments of Merchandise, we believe the long and complicated discussions in our opening brief and the brief of our opponents may have obscured the basic facts of the case. It may be appropriate, therefore, at the outset of our reply to make a chronological and brief statement of these facts.

On November 10th, there was a collected balance to Lofendo's account in the Branch of $13,061.17.

On November 10th, the Branch sent the four checks to Merchandise for collection.

On November 12th, Merchandise received the four checks, marked them paid, charged United's account and credited the account of Bank of America with their proceeds, $89,813.10.

On November 13th the Branch sent the six checks to Merchandise for collection.

On November 15th Merchandise received the six checks, marked them paid, charged United's account, and credited the account of Bank of America with their proceeds, $113,216.50.

On November 15th Bank of America gave Lofendo immediate credit for checks drawn by United on Merchandise for $97,207.00, and sent those checks to another Chicago bank for collection from Merchandise.

On November 15th the Branch received checks drawn by Lofendo on his account at the Branch for $75,586.86, but neither rejected nor charged them against the account. At the close of business on November 16th, Bank of America paid these checks by not having rejected them within the time prescribed by law. $51,862.36 of the proceeds of this payment went to reduce United's debt to Merchandise.

On November 16th the Branch received checks drawn by Lofendo on his account at the Branch for $109,569.15, and entered a debit for them against the

balance then posted to the credit of the account (the $13,061.17 of collected funds and the $97,207.00 of uncollected funds) thus paying $96,507.98 against uncollected funds, and, in effect, lending that amount to Lofendo. The entire proceeds of this payment by the Branch went to reduce United's debt to Merchandise. After the entry of this charge, the balance posted to the credit of the Lofendo account at the Branch was $699.02.

On November 16th the advices of credit for the four checks were received at the Branch.

At the close of business on November 16th, the situation was this: first, the ledger card of the account showed the credit balance of $699.02; second, Lofendo, according to Bank of America's contention, was entitled to the credits for the four and six checks (a total of $203,029.25); and third, Bank of America had paid the checks for $109,569.15 and $75,586.86 (a total of $185,156.01) drawn by Lofendo on the account, and $161,431.51 of this $185,156.01 had been paid to Merchandise to apply on account of United's indebtedness to it.

On November 18th, pursuant to the practice of delayed posting, Bank of America's internal bookkeeping entries showing the credit of $89,831.10 and the charge for $75,586.86 were posted to the account as of the 17th.

Late in the afternoon of November 18th, the Branch received notice that Merchandise had rejected the checks for $97,207.00.

On November 18th the advice of credit for the six checks was received at the head office of Bank of America to which it had been misdirected by Merchandise, and was forwarded by that office to the Branch. On November 19th the Branch received the advice of credit for the six checks, and on that day Bank of America's internal bookkeeping entries, showing the credit of $113,216.50 and the charge-back of the rejected checks for $97,207.00, were posted to the Lofendo account, leaving a balance to Lofendo's credit of $30,954.76.

II. MERCHANDISE'S CONTENTION THAT THE CHECKS WERE NOT PAID WHEN CHARGED AGAINST UNITED'S ACCOUNT IS ERRONEOUS.

1. The checks were paid by virtue of section 207(a)[1] of the Illinois Revised Statutes.

We argued this point on pages 17-20 of our opening brief.

Merchandise's answer is that the purpose of section 207(a) was to partially restore the former exceptional rule of Illinois in effect before its adoption of the Negotiable Instrument Law that a check operates as an assignment, that is if the bank fails to reject a check within the time specified by section 207(a), the lapse of time operates "not as payment," but "as an acceptance and thus as an assignment from the drawer to the payee or holder of the drawer's rights as creditor against his bank;" and that as Merchan-

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[1]This section of the Illinois Revised Statutes is also section 185a of the Illinois Negotiable Instrument Law.

dise's "acceptance" of the checks under section 207(a) was by mistake, it may revoke such acceptance (MB, 43-46).[2]

We dare say that if this were held to be the law no one would be more astonished than the bankers of this country. But it is nothing more than a rather ingenious but fantastic argument.

A check is payable by the bank on which it is drawn on presentation.[3] And in *State Bank of Chicago v. Mid-City Trust & Savings Bank,* 295 Ill. 599, 129 N.E. 498, the court said:

> "* * * Section 184 of the Negotiable Instruments Act (section 202) provides that the provision of the act applicable to bills of exchange apply to a check, and section 131 (section 149) that the acceptance of a bill must be in writing signed by the drawee. Payment is the final act which extinguishes a bill. Acceptance is a promise to pay in the future and continues the life of the bill."

When section 207(a) as it stood in 1948 provided that a drawee bank "is allowed until the end of the next business day following the day of presentation to decide whether it will *pay* the check,"[4] it meant presentation for payment, not acceptance; and it meant a payment which would extinguish the check, not an acceptance which would keep it alive. And the section

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[2]"MB" signifies Merchandise's brief.

[3]Ill. Smith-Hurd Ann. St. Ch. 98, secs. 206 and 207; Cal. Civil Code, sec. 3265(a) and 3265(b).

[4]The section is quoted in full on page 18 of our opening brief.

says that the bank shall be allowed the time to decide whether to *"pay"*, not to decide whether to accept.

Section 211 of the Illinois Revised Statute contains that provision of the Negotiable Instrument Law that "A check of itself does not operate as an assignment." If as Merchandise contends, the Illinois legislature had intended to modify this rule by the adoption of section 207(a), it would have made its intention clear by amending section 211 to provide that "A check of itself does not operate as an assignment except to the extent provided in section 207(a)."

But section 207(a) was not intended to modify section 211. Illinois adopted section 207(a) for the same reason that California adopted the comparable provision of section 16(c) of the Bank Act,[5] that is to lay down a precise and definite rule prescribing the time within which a bank to paraphrase the language of section 16(c), must either find a check good or return it unpaid. As checks in our economy function practically as currency, it is essential that the question whether or not they have been paid be governed by such a rule. And if Merchandise is right in its contention that section 207(a) modified in Illinois the rule of the Negotiable Instrument Law that a check does not operate as an assignment, then section 16(c) had the same effect in California; but this would be absurd.[6]

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[5]This provision of section 16(c) is quoted in a footnote on page 19 of our opening brief.

[6]Merchandise says in a footnote on page 43 of its brief that the 1949 amendment to section 207(a) "completely changed" the

In answer to our claim that LeRoy in his conversation with Duncan claimed the advantage of the provision of section 16(c) comparable to section 207(a), but that his bank desires to repudiate the rule of section 207(a) when it works to its disadvantage (OB, 19-20),[7] Merchandise says that the checks to which LeRoy referred were sent out in a cash letter (MB, footnote 15).[8] But this fact makes no difference at all. Section 207(a) provided that "The drawee bank named in a check presented to it by mail or through a clearing house association or through a settlement with another bank or for deposit in an account" is allowed the time therein prescribed to decide whether it will pay the check. The section applies to all checks no matter how presented for payment.

Merchandise argues that *Rock Finance Co. v. Central National Bank of Sterling,* 339 Ill. App. 319, 89 N.E. (2d) 828, supports its claim that a bank by permitting the time prescribed by section 207(a) to

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section. Section 207(a) as it stood in 1948 provided that a bank is allowed until the end of the next business day following the day of presentation to decide whether or not it will pay a check presented to it; whereas, the section as amended provided that a bank may reject such a check, but must do so not later than midnight of the bank's next business day after the item was received. Although the verbiage of the section was changed by the amendment, its substance remains the same.

[7]"OB" signifies Bank of America's opening brief.

[8]Whenever Merchandise is at a loss for an argument, it bases its claim on the difference between cash and collection letters. But as we shall show these claims, as in the case of the one referred to in the text, are made up out of whole cloth and are utterly fallacious.

elapse does not pay a check, but only accepts it (MB, 45-46). The case does not support the claim at all.[9]

2. Merchandise's efforts to distinguish Bank of America's authorities are futile.

Merchandise says that the holding of cases like *Hay v. First National Bank,* 224 Ill. App. 286, and *American Exchange National Bank v. Gregg,* 138 Ill. App. 596, 28 N.E. 839, in which both the payee and the drawer had their accounts in the same bank, do not apply because in them "the situation is the same as if he [the payee] had presented the check, received the cash, pushed it across the counter and redeposited it" (MB, 94). But when the drawee bank marks the check paid and charges the account of the drawer, it is payment, whether or not the payee has his account with it. The courts say that in either case the situation is the same as though the drawee had paid the money over the counter. In *Hallenbeck v. Leimert,* 295 U.S. 116, 55 S. Ct. 687, one of the cases cited by us in this connection, the court, in holding that the Central Bank had paid checks to the forwarding bank by not rejecting them on the day of their presentation, said:

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[9] All that the court in this case held was that under section 207(a) the defendant bank had until midnight of the next business day following the presentation of checks to decide whether to pay them; that therefore the plaintiff's contention, that the bank's failure to act before 3 P.M. of that day constituted under the section an implied acceptance of liability on the checks, could not be sustained; and that the summary judgment in favor of the bank should be affirmed.

> "We think the conduct of Central Bank constituted irrevocable payment of the five checks, as if cash had passed over the counter."

Merchandise claims that other cases cited by Bank of America in this connection, like *Security National Bank v. Old National Bank,* 241 Fed. 1, and *Hayes v. Tootle-Lacy National Bank,* 72 Fed. (2d) 429, are not in point because they involved the rights of holders in due course and did not involve fraud or mistake (MB, 96-97). The question whether a payee is a holder in due course or whether a bank has been induced by fraud or mistake to pay a check becomes relevant when a bank has paid it and is seeking to recover the payment; but neither question has a bearing on the question whether the check has been paid. Bank of America's cases show that when a bank marks a check paid and charges the account of the drawer, the check is paid whether or not the drawer has sufficient funds to his account to pay it. The question whether Merchandise can recover its payment of the checks is a totally distinct question with respect to which totally different considerations and authorities are relevant.

Merchandise cites *Friedman v. Irving Trust Company,* 300 N.Y.S. 51; *Pacific National Agricultural Credit Corporation v. Wilbur,* 2 Cal. (2d) 576, 42 Pac. (2d) 314, and *Bohlig v. First National Bank,* 48 N.W. (2d) 445 (Minn.), in support of its statement that courts have held that where a drawee bank

marks a check paid and charges the drawer's account, it does not pay the check (MB, 79).

In the *Friedman* case the court held that the closing of the forwarding bank terminated both its agency and the subagency of the defendant bank for the collection of the checks and that, therefore, the defendant bank made itself liable for the conversion of checks by collecting them and crediting them to the forwarding bank's account after knowledge of the closing of the forwarding bank.

In the *Wilbur* case, the court held that in the absence of a special agreement a chattel mortgage taken in place of a prior mortgage was not a satisfaction of the first mortgage, but a renewal of it and that therefore the defendant was liable for the conversion of sheep which were subject to the first mortgage and which the defendant had sold before the execution of the second mortgage.

In the *Bohlig* case the court held that the drawer of a check could stop payment at any time while the funds continued subject to the control of the drawee bank.

None of these cases supports in any way whatever the proposition in support of which Merchandise cites them.

Merchandise repeats that Bank of America "paid" or "honored" the checks for $109,569.15 by charging them against Lofendo's account on November 16th (MB, 11; 18-19). Is it not absurd for Merchandise

to say that Bank of America paid these checks by charging them against Lofendo's account and at the same time claim that Merchandise did not pay the four and six checks by similar acts?

3. Merchandise's claim, that the credit balances against which the four and six checks were charged were "apparent" and not good balances is not sound.

We argued this point on pages 22-28 of our opening brief.

Merchandise does not challenge in any way our statement of the facts on which our argument was based (OB, 22-26).

The principal answer Merchandise makes to the argument is simply that as United obtained by fraud its loans credited to its account, such credits created "apparent," not real credit balances (MB, 6; 46-47).

But the loans were made; and so on November 12th and 15th, the dates on which the four and six checks were charged against the account, Merchandise was indebted to United in the amount so credited to United's account, subject, however, to Merchandise's right to disaffirm the loans on the ground that they had been obtained by fraud and to cancel and restore to United its notes, and subject to Merchandise's right to offset its indebtedness to United against United's indebtedness to it. But it did not disaffirm or exercise its right of offset until the four and six checks had been charged against the account, and so when they were charged against it, there was a good, not an apparent balance in the account.

Suppose a bank is induced by fraud to loan a customer $10,000.00 which is credited to his account. Can the bank while it still holds the note evidencing the loan and before it has disaffirmed the transaction maintain that the $10,000.00 credit is fictitious and that therefore checks charged against the credit have not really been paid?

Merchandise says that Bank of America's argument was "rejected" in *Steinhart v. National Bank,* 94 Cal. 362, 29 Pac. 717 (MB, 47-48); and it relies heavily on this case. In the *Steinhart* case the bank pursuant to the instructions of the maker of a note charged it against the maker's account and marked the note paid and drew a check in payment of the note; but having discovered on the same day that the maker had made an assignment for the benefit of creditors and was overdrawn, it cancelled the check and reversed the entries. The court held that the holders of the note could not recover the amount of the note from the bank on the theory that the bank had paid it because the transaction so far as the holders were concerned was "incomplete," and that if the transaction were regarded as a contract on the part of the bank to loan the maker the money to pay the note, the bank had a right to rescind it on the ground of mistake. The case is not in point and does not reject Bank of America's argument at all.

Merchandise argues that "While United Produce's commercial ledger sheet on plaintiff's books had a credit figure, that sheet was not United's account

with plaintiff;" but that United had "one account" with Merchandise recorded not only in the ledger of its commercial account, but in the other ledgers maintained by Merchandise to show its transactions with United;[10] and that "the true balance of the account could be ascertained only by consulting all the papers together," and that when "so consulted, there was no credit balance" (MB, 49).

If a bank makes a demand loan of $10,000.00 to a man and records the loan on a ledger sheet, and if it credits the proceeds to the man's commercial account, the books of the bank will show that the man has a credit balance of $10,000.00 against which he can draw checks; and this is so whether one says that he has two accounts with the bank or only one; and he has the right to draw checks against the credit until the bank eliminates the credit by exercising its right of offset.

But the law is that a bank pays a check under statutes like section 207(a) by not rejecting it in time; and that a bank pays a check by marking it paid and charging the account of the drawer; and that it pays either in one way or the other whether or not the drawer has sufficient funds on deposit to meet the check. And so Merchandise paid the four and six checks whether or not the balances to United's account were "apparent" and not good balances.

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[10]These other ledgers were the "note liability ledger", which showed the notes executed by United to Merchandise; "the assigned accounts receivable ledger", which showed the assignments of receivables and the amount of the remittances; and "the draft discount ledger", which showed the drafts of United discounted by Merchandise (Deft's Ex. NN; IV; 1274-1285).

III. MERCHANDISE'S CONTENTION, THAT UNDER THE COLLECTION CONTRACT BETWEEN LOFENDO, BANK OF AMERICA AND MERCHANDISE COLLECTION AND PAYMENT WERE NOT CONSUMMATED UNTIL BANK OF AMERICA MADE BOOK ENTRIES ON MERCHANDISE'S ACCOUNT WITH IT, IS ERRONEOUS.

1. Statement of this contention by Merchandise.

Merchandise argues that under the contract between Lofendo, Bank of America, as the forwarding bank, and Merchandise, as the collecting bank, collection and payment of checks sent by Bank of America to Merchandise "were consummated only by a charge made against" Merchandise's "account on" Bank of America's "books in San Francisco pursuant to an outstanding authorization to make it," and that "nothing short" of such a charge could change the relationship of Bank of America and Merchandise from that of agent and subagent for Lofendo to that of creditor and debtor (MB, 34-35; 80; and 82-83). "The vital question," it says, is "what was the contract" (MB, 82).

For Merchandise, this is the crucial contention, the foundation of its most vital arguments. If Merchandise cannot make this contention good it cannot prevail. But the converse is not true; as we shall see, Bank of America can defeat Merchandise's claims even though this contention of Merchandise were sound.

In considering Bank of America's answers to this contention we should have in mind that when a forwarding bank sends a check directly to the drawee bank for collection and payment, the forwarding bank

is acting as agent of the depositor and the drawee bank is acting in a dual capacity; in the first place the drawee bank is acting as the subagent of the depositor to present the paper to itself, collect it and transmit the funds to the forwarding bank; and it is also acting as the drawee bank, charged with the duty of paying the check if it has funds of the drawer in its hands. 9 C.J.S. 486, sec. 232. There is no controversy about this.

2. **The attempted revocation by Merchandise of the advice of credit for the six checks did not alter the fact that these checks had been collected and paid.**

Merchandise concedes that the checks were paid when the charges were made against its account with Bank of America, provided that the charges were authorized by an advice of credit. It says that the advice of credit for the six checks was revoked before the charge against its account was made, and that therefore the charge was not authorized (MB, 28).

In *Rickey v. New York State National Bank,* D.C. N.D. N.Y., 7 F. Supp. 29 (affirmed without opinion 70 F. (2d) 1020 and cited on page 33 of our opening brief), the court said:

> "The notice of the payment of the Barker draft was no part of the transaction itself, but only evidence of the transaction. The legal effect would be the same if the notice had never been made or mailed."

In *Dean Tobacco Warehouse Co. v. American National Bank,* 123 Tenn. 365, 117 S.W. (2d) 746 (cited on page 33 of our opening brief), the court said:

> "* * * When the credit was given the transaction was completed. The notice of the payment of the check was not part of the transaction itself, but only evidence of the transaction. Rickey v. New York State Bank, supra; People v. Sheridan Trust and Savings Bank, supra; Storing v. First National Bank, 8 Cir., 28 F. 2d 587, 589."

The advice of credit for the six checks was merely a notice that Merchandise had paid the checks and granted the credit. It did not create or affect the rights of the parties. Those rights were fixed by the facts, by what had taken place. And so Merchandise's attempted revocation of the advice of credit for the six checks did not operate like an order stopping payment of a check; but the rights of the parties remained exactly what they were, regardless of such revocation.

3. **If Merchandise were right in its contentions, the four checks were paid.**

But in any event Merchandise did not attempt to revoke the advice of credit for the four checks. And so if Merchandise were right in its contention that the checks were not collected and paid until Bank of America charged Merchandise's account, and that Bank of America could not make such a charge until it had in its hands an unrevoked advice of credit, even so the four checks according to its own contention were paid.

4. **The California Bank Act does not support Merchandise's contention.**

Merchandise says that its contention, that the contract was that collection and payment could only be consummated by the entry of debits against Merchandise's account, is "fortified" by section 16c of the California Bank Act. It claims that this is so because the section did not authorize Bank of America to accept in payment of the four and six checks a credit with Merchandise, but that on the contrary the section forbade it from doing so (MB, 58-59; 89-90).[11]

Prior to the adoption in 1925 of section 16c, the California law was that a bank having paper for collection could only receive money in payment and that if it took something else it did so on its own responsibility and its liability to its depositor thereupon became fixed, as much as though it had received the cash. *Luckehe v. First National Bank of Marysville,* 193 Cal. 184, 223 P. 547.[12] And the law elsewhere was the same. 9 C.J.S. 498-499, sec. 243. In the *Luckehe* case the court said:

> "* * * Having no authority to receive, in payment of commercial paper entrusted to it to collect, anything but money, a bank accepting negotiable paper in lieu of currency, for a draft, it

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[11]Merchandise says that "if the law of the state where the depositor and forwarder are located will permit" the forwarder to accept in payment a credit on the books of the collecting bank with which the forwarder has an account, then such a credit can be regarded as payment; but that "In California this is forbidden" (MB, 89-90 and footnote 45, p. 90).

[12]Merchandise cites this case on page 64 of its brief.

> was employed to collect, does so upon its own responsibility. (Citing cases) * * * If the collecting bank surrenders the check to the bank upon which it is drawn, and accepts a cashier's check or other obligation in lieu thereof, its liability to its depositor is fixed, as much so as if it had received the cash (Fifth National Bank v. Ashworth, 123 Pa. St. 212 [2 L.R.A. 491, 16 Atl. 596]), and it must be held to have immediately become indebted to its depositor in the amount which the paper represents."

In *Utah Construction Co. v. Western Pacific Railway Co.,* 174 Cal. 156, 162 P. 631, the forwarding bank instructed the drawee-collection bank to credit checks to the account which the forwarding bank had with the collecting bank. The collecting bank entered the credit and then closed its doors. The court held that the payee was bound by the act of its agent, the forwarding bank, and that consequently the checks were paid by the entering of the credit and the drawer discharged from liability. The court said:

> "* * * The presentation of the check and the acceptance of credit instead of payment was a waiver of payment. The railway company [the drawer] did not authorize the taking of credit. That act created the relation of debtor and creditor between the Safe Deposit Company [the drawee-collecting bank] and the Ogden bank [the forwarding bank] and satisfied the check. * * * But here the checks, though not agreed to be taken as payment, were satisfied by the taking of credit therefor."

Although the point was not before the court and was not discussed, it is clear that in this case the forwarding bank would have been liable to its principal for taking the credit rather than money in payment of the checks.

Section 16c of the California Bank Act changed the rule of the *Luckehe* case.[13] (The section was adopted in 1925, the year following the *Luckehe* decision.) It provided that a bank may forward a check for collection directly to the bank on which it is drawn; and then it contained a provision, which we for convenience shall call "the payment provision", reading as follows:

> "* * * and in payment thereof there may be accepted either money or the check or draft of the bank on or by which it is drawn, or at or through which it is made payable, or the check or draft of any bank to or through which it has been forwarded for collection, or credit therefor may be accepted with any Federal reserve bank, or with any bank designated as a depositary by *the bank allowing such credit.*"

Merchandise says that under the section Bank of America could have accepted a "credit on the books of any bank *designated by Merchandise* [our own emphasis] as a depositary," but that "A credit on

[13]Section 16c was superseded by the adoption in 1949 of sections 1010 to 1019 of the California Banking Code; and these latter sections were in turn superseded by the adoption in 1951 of the California Financial Code; but as section 16c was in effect in 1948, it controls this case.

Merchandise's own books is not recognized by the statute, since plaintiff could not be its own depositary, nor was it defendant's depositary" (MB, 58-59).

In other words, Merchandise claims that the italicized expression at the end of the payment provision gives the collecting drawee bank (not the forwarding bank) the power to designate the depositary the credit of which can be accepted in payment under the section.

The first clause of the section provides that "Any credit allowed by any bank * * * for any check * * * drawn on * * * any other bank * * * shall be provisional only subject to final payment and to the receipt by *the bank allowing such credit* of the funds in actual money or in solvent credit on the books of any Federal Reserve bank or on the books of any bank designated as a depositary by *the bank allowing such credit.*" Obviously the expression in the first clause which we have italicized means the forwarding bank, not the collecting-drawee bank; and obviously also this expression in the first clause means the same thing as the same expression in the payment provision which we have italicized. And then the last sentence of the section reads that "Until the proceeds of any such check * * * shall have been actually received by *the bank allowing such credit* in actual money, or in solvent credit on the books of any Federal Reserve bank or on the books of any bank designated as a depositary by *the forwarding bank,* such checks * * * may be charged back to * * * the party from whom it was received * * *" Again the expression "the

bank allowing such credit" means the forwarding bank; and in this last clause the bank which has the power to designate the depositary is actually referred to as the "forwarding bank."

It would have been a strange thing if the statute had provided that the collecting-drawee bank could designate the depositary the credit of which could be accepted in payment rather than the forwarding bank to which a depositor intrusts his paper for collection and which has the primary responsibility for its collection.

Merchandise's contention that section 16c gives the collecting-drawee bank the power to designate the bank whose credit is to be accepted in payment is entirely and absolutely wrong.

Merchandise's statement that section 16c "forbids" a forwarding bank to accept a credit of another bank in payment (MB, 89-90 and footnote 45, p. 90) is unadulterated nonsense. The payment provision states that a forwarding bank *"may"* accept the things therein specified as payment. Furthermore, if a forwarding bank accepted something else in payment, then the rule of the *Luckehe* case would apply, that is, the check would be paid and the bank would immediately become responsible to its depositor just as though it had taken cash.

There can not be the slightest doubt that section 16c changed the rule of the *Luckehe* case by providing that a forwarding bank could accept in payment the things specified in the payment provision, includ-

ing the credit of any bank designated by it as a depositary. Bank of America, therefore, was authorized by this section to accept in payment of the four and six check credits with Merchandise.

5. **The "contract" between Lofendo and Bank of America as established by the law and banking practice was that Bank of America could accept in payment of checks forwarded for collection credits with Merchandise.**

As stated, Merchandise contends that "the contractual arrangement" between Lofendo, Bank of America as the forwarding bank and Merchandise as the collecting-drawee bank must control (supra, p. 14).

On some occasions when checks drawn by United to Lofendo's order came in the mail to the Branch, the Branch gave Lofendo immediate credit for them (subject to charge back under section 16c of the California Bank Act if not paid) and on other occasions it did not give him credit but sent the checks on for collection (IV, 1175-1176). In the banking business throughout the United States checks are transmitted by banks to other banks for collection either by means of cash letters or collection letters (IV, 1186). If the bank gives immediate credit subject to charge back it uses a cash letter (IV, 1186); but if it does not give such a credit, it uses a collection letter containing instructions how to remit the funds (IV, 1186-1187). When Lofendo caused the checks to be delivered to Bank of America, it had the right to assume that he wanted it to follow either one or the other of these customary ways of collecting checks, provided that

it contravened no rule of law.[14] Furthermore, Lofendo and Bank of America are presumed to have contracted with reference to section 16c and the provisions of that section are in effect a part of the contract. *Federal Reserve Bank v. Malloy,* 264 U.S. 160, 164, 44 S. Ct. 296, 298; *Dakin v. Bayly,* 290 U.S. 145, 147, 54 S. Ct. 113, 115 (a case much relied on by Merchandise). And so Lofendo impliedly agreed that Bank of America could collect the four and six checks by sending them directly to the drawee bank for collection;[15] that Bank of America could accept in payment anything which a bank was authorized by section 16c to accept, including the draft of or a credit with

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[14]In *Davis v. First National Bank of Fresno,* 118 Cal. 600, 602-603, 50 Pac. 666, the court said:

> "* * * One who gives a draft to a bank to collect is held to have an implied knowledge of its usage in collecting drafts, so far as such usage does not contravene any rule of law. (Morse on Banking, sec. 9; Bank of Washington v. Triplett, 1 Pet. 25.) 'The fact that one deals with the bank without taking the trouble to inquire as to its system will raise the implication that he already knows and is satisfied with that system. It is clear that if a person hands over a note to a bank for collection, without any species of remark as to the course to be pursued, the bank is not bound to thrust upon him a statement of its intended course and to retain him until the whole theory had been expounded to him, when his conduct unmistakably shows that either he already knows it, or else he does not desire to know it. Either he knows and approves it, or he voluntarily trusts to the wisdom of the bank at his own deliberately assumed risk of its sufficiency. In such a case the bank not only has a right to assume, but it is even positively bound to assume, that his desire is that the ordinary and established usage be pursued.' (Morse on Banking, sec. 221.)"

[15]Section 16c provides that a forwarding bank could forward a check directly to the drawee bank for collection. Prior to the adoption of this statute the law was that a forwarding bank could not send a check to the drawee bank for collection and that if it did, it was responsible if the check was not collected. 9 *C.J.S.* 504, sec. 247.

Merchandise. But under the rule of the *Luckehe* case if Bank of America had accepted in payment something which it was not authorized to accept, it did so on its own responsibility and its liability to Lofendo thereupon became fixed just as though it had received the cash.

So much for the contract between Lofendo and Bank of America under which the collection was made.

6. Merchandise upon giving the credit became the owner of the fund.

When Merchandise gave Bank of America the credits, it acknowledged itself indebted to Bank of America. This is what the giving of a credit means in plain English.

And when Merchandise charged United's account and credited Bank of America, it thereupon became the owner of the proceeds of the checks, which proceeds passed into its general funds. This is one of the crucial facts in the case. And it is one of the principal reasons advanced by those cases on which Bank of America relies for their holding that where the instructions of the forwarding bank are to collect and credit, there is a change in relationship to that of debtor and creditor as soon as the collecting-drawee bank gives the credit (OB, 32-35).

7. **The "contractual arrangement" between Bank of America and Merchandise: Under it the checks were collected and paid when Merchandise gave its credits, regardless of when Bank of America entered these credits on its books.**

The simple and clear proof of this arrangement was the instructions given by Bank of America, as Lofendo's agent, to Merchandise, as his subagent, by the collection letters and Merchandise's response thereto by the advices of credit.

It will be recalled that each of the collection letters stated that the checks described in it "were enclosed for collection;" that the "documents" (either the four or the six checks) should be delivered "only on payment;" that Merchandise should "make separate remittance or credit for this collection as indicated below;" and that Merchandise should "dispose of the proceeds" by crediting Bank of America with advice to the Branch instead of following one of the alternative methods of remitting the funds by draft.[16]

It will also be recalled that Merchandise, after marking the checks paid and charging them to United's account and crediting Bank of America on its ledger, sent Bank of America its advices of credit stating in effect that the checks had been paid and that it had credited Bank of America's account.

Merchandise maintains that "the request in the collection letter to credit Bank of America was "a re-

[16]The collection letter accompanying the six checks is reproduced on page 1268 of the record. It was stipulated that the collection letter accompanying the four checks was in the same form as the collection letter accompanying the six checks (I, 302-303). The provisions of the collection letter are stated somewhat at length on pages 35-36 of Bank of America's opening brief.

quest" by Bank of America "for written authority to credit itself by charging" Merchandise's "account in San Francisco;" and that until this "occurred the funds were not 'disposed of' ", that is, disposed of within the meaning of these words as used in the collection letter (MB, 85).

The most sophistical sort of argument cannot distort the simple facts of this case into such an arrangement. Bank of America was authorized by section 16(c) to accept credits with Merchandise in payment of the checks. The collection letters directed Merchandise to give Bank of America credits in payment. Merchandise charged United's account and became the owner of the proceeds of the checks and gave Bank of America the credits and notified Bank of America that it had done so. This was the contractual arrangement between the banks and nothing else.

Merchandise says that under "the contractual arrangement" the funds were not transmitted to Bank of America until Bank of America had charged Merchandise's account with it (MB, 94).

As the contractual arrangement evidenced by the collection letters was that Bank of America would accept payment by credits, the funds were *ipso facto* transmitted when the credits were granted.

In *Commercial National Bank v. Armstrong,* 148 U.S. 50, 13 S. Ct. 532,[17] the forwarding bank, referred

[17] In their research counsel for Bank of America did not discover this case until after their opening brief was filed and so it is not cited therein.

to in the opinion as "Fidelity," was indebted to certain of its subagents, the collecting banks, and these subagents upon collecting the various checks sent them for collection and payment, entered in their books credits upon Fidelity's indebtedness to them. The court in holding that Fidelity had received the funds upon the giving of the credits said:

> "We also agree with the circuit court, in the conclusions as to those moneys collected by subagents to whom the Fidelity was in debt, and which collections had been credited by the subagents upon the debts of the Fidelity to them before its insolvency was disclosed; for there the moneys had practically passed into the hands of the Fidelity. The collection had been fully completed. It was not a mere matter of bookkeeping between the Fidelity and its agents. It was the same as though the money had actually reached the vaults of the Fidelity. It was a completed transaction between it and its subagents, and nothing was left but the settlement between the Fidelity and the principal,—the plaintiff."

This conclusion is in accordance with section 440 of the California Code of Civil Procedure which provides that cross-demands shall be deemed compensated so far as they equal each other.

Banks do not pay one another by transmitting currency; but by credits or drafts.

And it will be recalled that section 16(c), after providing that a forwarding bank may accept a credit in payment of a check, provides that until the pro-

ceeds of a check "shall have been actually received * * * in solvent credit on the books of any bank designated as a depositary by the forwarding bank," it may be charged back. The credits granted by Merchandise were solvent, and when they were granted Bank of America had "actually received" payment by means of such credits.

But whether or not the funds are to be deemed to have been actually transmitted upon the giving of the credits the fact is that when Merchandise pursuant to the collection letter charged United and credited Bank of America, it thereupon became the owner of the fund and ceased to be a subagent for collection of the checks and became indebted to Bank of America and Bank of America became indebted to Lofendo.

8. Merchandise's contention that there was no consideration for a change in relationship raises a false issue.

Merchandise argues that if there were a change in relationship from agency to debtor and creditor, it must be based upon a supposed contract by Merchandise to pay Bank of America; that the only consideration supporting such a contract would be Bank of America's assumption of Merchandise's obligation to Lofendo; but that there was no consideration for such a contract, because Merchandise by reason of United's fraud had no obligation to Lofendo (MB, 33; 56-57). And it also says that if such a contract had been supported by a consideration, it would have been a contract for the benefit of Lofendo which under Cali-

fornia Civil Code section 1559 could be rescinded by the parties to it without Lofendo's consent (MB, 61).

The contention is entirely fallacious.

When Merchandise gave the credits, it was not making a promise to Bank of America for the benefit of a third party, Lofendo, in consideration of Bank of America's promise to assume Merchandise's obligation to Lofendo; but it as the collecting-drawee bank was simply collecting and paying the checks in accordance with the instructions given it by Bank of America while acting as Lofendo's agent for their collection; and at the same time it was becoming the owner of the proceeds of the checks. When Merchandise gave the credits, it was not assuming any obligation to Lofendo at all and Bank of America was not promising to assume any obligation of Merchandise to Lofendo, but Merchandise was simply acknowledging itself indebted to Bank of America. And when Bank of America was given these solvent credits, it in its turn became indebted to its depositor, Lofendo.

9. Merchandise relies on irrelevant matters to establish the contractual arrangement for which it contends.

(a) The bookkeeping practice of Bank of America, in making charges against Merchandise's account with it, was wholly unrelated to either the time or the fact of payment.

When Bank of America sent to Merchandise for collection a check drawn on it, Bank of America's bookkeeping practice was not to enter the charge against Merchandise's account (carried on head office books at San Francisco) until the branch where the

collection had originated had authorized the head office to make the entry (I, 181).

This practice could not modify the collection arrangement between Lofendo and Bank of America and between the latter and Merchandise established by the circumstances just reviewed (supra pp. 22 to 28) by substituting for it the totally different arrangement for which Merchandise contends (MB, 15-16; 82), that is that the collection and payment of the checks were not to be consummated until Bank of America charged Merchandise's account.

Suppose, for example, that the branch after receiving on November 16th the advices of credit for the four checks had neglected to send the head office of the bank a memo that the advice had been received and that Merchandise's account should be charged;—would it then have been possible for the branch to say to Lofendo, "Yes, we have received in payment of the checks a solvent credit which Merchandise has allowed us and which we were authorized by the Bank Act to accept and Merchandise has the funds and is using them and we have received from Merchandise its advice that it, pursuant to our instructions, has given us credit, but we have not directed the head office to charge Merchandise's account and so the checks have not been collected and paid." The suggestion is absurd.

The facts must control the rights of the parties; not whether or not bookkeeping entries were made at Bank of America's head office.

(b) The difference between cash and collection letters does not support Merchandise's contention respecting the contractual arrangement.

Merchandise claims that this difference supports its claim now under consideration (MB, 13-15; 87-88).

It was stipulated that "in the banking business throughout the United States checks are transmitted by banks to other banks for collection either by means of 'cash letters' or 'collection letters' ".

The essential fact is that both cash and collection letters are simply different methods of collecting checks.

The bank to which a cash letter comes gives credit to the forwarding bank immediately upon receipt of the letter subject to charge back if the check is not paid and the forwarding bank assumes collection unless advised of rejection; whereas, the collection letter contains instructions on how to remit the funds (whether by a credit or draft) and the forwarding bank does not assume collection until advised thereof (IV, 1186-1187). The credit granted pursuant to a cash letter can have no different legal effect from a credit granted pursuant to a collection letter; and the fact, that in one case the forwarding bank assumes collection if not advised to the contrary, but in the other does not make such assumption but awaits advice, is of no significance whatever.

Tarr, the chief clerk of the Branch (II, 560), testified that after October 22nd he put a "hold" on the Lofendo account, that is the Branch gave Lofendo provisional credit for the checks deposited to his account, but did not pay against them until they had

a chance to clear (II, 563; 581-582). The only practical difference between this way of handling checks and taking the checks for collection is that when the former method is used the bank will pay against the credit after allowing the checks time to clear; whereas, when the latter method is used the bank will not pay until it learns by mail, telegraph or telephone that the check has been paid. (See Estribou's testimony, I, 352; 407-408.) When the former method is used, the checks are collected by cash letter, while in the latter they are collected by collection letter. Certainly this insignificant difference between these two methods of collecting checks does not, as Merchandise says it does, tend to show that the contractual arrangement was something different from that established by the simple words of the collection letters themselves; in other words, that this contractual arrangement was that checks should not be deemed to have been collected and paid until Bank of America made the charges against Merchandise's account and that until then there was no change in relationship.

(c) The record in which Merchandise entered the credits was not at all analogous to a ''check stub''; its entry of the credits therein evidenced its giving of the credits.

Messenger testified that Merchandise entered in the ordinary course of business on Defendant's Exhibit H (the ledger card kept by Merchandise to show its transactions with Bank of America) debits in favor of Merchandise and credits in favor of Bank of America; but that the document was an ''internal'' docu-

ment and no copy of it was sent Bank of America (I, 312-313; 322-323).

A comparison of Defendant's Exhibit H with Plaintiff's Exhibit 1 (the ledger card kept by Bank of America to show its transactions with Merchandise) shows that they are substantially the same sort of record. One was no more "internal" than the other.

To say as Merchandise does that Defendant's Exhibit H was analogous "in every respect" to a check stub of a depositor in a bank (MB, 85-86) is preposterous. *Bank of America by the collection letters asked Merchandise to pay the checks by giving the credits and Merchandise gave them.* The entry merely evidenced that important act.

(d) The acts alleged to constitute "practical construction" of the contractual arrangement were unrelated to any contract.

Merchandise says that its conception of the contractual arrangement is supported by the practical construction of the parties (MB, 83).

17 C.J.S. 763, sec. 325(b) states:

> "* * * Practical construction by conduct of the parties is a matter of knowledge and intention. To create a practical construction by acts of the parties, such acts must be done in pursuance of and by reason of the contract and with full knowledge of its terms; * * * and they must be direct and positive, as distinguished from acts of a doubtful or dubious character."

See, also, *Barnhart Aircraft Inc. v. Preston,* 212 Cal. 19, 24, 297 P. 20, 22.

In the Messenger-Estribou conversation and in the LeRoy-Duncan-Johnson conversations there was no reference of any sort to the contract which Merchandise claims existed, that is a contract that checks should not be collected and paid until Bank of America charged Merchandise's account and that until then there should be no change in relationship. There is nothing in the conversations to show that any of these men had any such alleged contract in mind or any intention to act under it. All that the conversations show is that the officers of Merchandise were claiming that the advice for the six checks had been sent out in error and that therefore they had a right to rescind it, and that the officers of Bank of America, believing that the Lofendo account was in the clear and having been told that Merchandise had been defrauded, was willing to follow the instructions of Merchandise.[18]

The conversations were not "direct and positive" acts deliberately performed with knowledge of the alleged contract and an intent to act under it. They had no bearing whatever on the alleged contract. They cannot be considered a practical construction to any extent whatever.

10. Conclusion respecting the point.

The contractual arrangement between Lofendo, Bank of America and Merchandise under which the

[18] See Messenger's testimony (I, 220-223); LeRoy's (II, 459; 480-481; 484; 485; 487-488); Estribou's (I, 396-398); Johnson's (II, 690-692; 697-698).

checks were collected was that Bank of America as Lofendo's agent would accept in payment the credits given by Merchandise as it was authorized to do by section 16(c). When Merchandise gave these credits, the checks were collected and paid. Merchandise became the owner of their proceeds, the agency of Bank of America and Merchandise for the collection of the checks was fulfilled and terminated and Merchandise became indebted to Bank of America and Bank of America to Lofendo.

The contention of Merchandise that the contractual arrangement was that the checks were not collected and paid until Bank of America charged Merchandise's account with it is not supported by the matters on which Merchandise relies to support it and is utterly erroneous.

IV. MERCHANDISE'S ATTEMPT TO DISTINGUISH BANK OF AMERICA'S CASES RELATING TO THE POINT THAT DEBTOR-CREDITOR RELATIONSHIP BETWEEN THE BANKS WAS ESTABLISHED WHEN MERCHANDISE GAVE THE CREDIT IS FUTILE; AND THE CASES ON WHICH IT RELIES RESPECTING THE POINT DO NOT SUPPORT IT.

1. As pointed out in our opening brief, the basic distinction in the cases is between those in which the instructions are to collect and remit and those in which the instructions are to collect and credit. When the instructions are to collect and remit, there is a conflict in the cases respecting the result, some courts holding that where the instructions are to collect and remit the agency is terminated and the debtor-creditor

relationship established upon the check being collected and paid, while other courts hold that in such a case the collecting-drawee bank upon paying the check continues to hold the fund as agent and that therefore the fund may be impressed with a trust. But there is no conflict where the instructions are to collect and credit; in such cases the courts hold without conflict that the collecting-drawee bank upon paying the check becomes the owner of the fund and the agency is terminated and the debtor-creditor relationship established (See Bank of America's opening brief, pp. 30-35).

Merchandise says that the cases on which Bank of America relies, the cases in which the instructions are to collect and credit, can be eliminated "out of hand" because they involved "a different contractual arrangement" (MB, 86-87). These cases did not involve a different arrangement. In them as in the case at bar the instructions were to collect and credit. They are precisely in point and decisive.

2. Merchandise also says that there is a vital difference between the case in which the forwarding bank gives its depositor a provisional credit as in the case of a cash letter and the case in which it does not enter such a credit until advised that the check has been paid as in the case of a collection letter; that in the former case there is a change in relationship from agency to debtor-creditor when the collecting-drawee bank pays the checks by giving the credit; whereas, in the latter case such a change in relationship does not occur until the forwarding bank enters

the credit (MB, 87-88). The attempted distinction is entirely untenable. A check is collected and paid when the collecting-drawee bank charges the depositor's account and gives the forwarding bank credit; at that time the purpose of the agency is fulfilled and the collecting-drawee bank becomes the owner of the proceeds of the check and indebted to the forwarding bank and the latter bank to the depositor; and this is so, whether or not the forwarding bank gives the depositor provisional credit upon receiving the check. The facts, not an unimportant book entry, control the rights of the parties.

Merchandise infers from the statements of fact made in the cases cited by Bank of America on pages 33-34 of its brief (cases holding that where the collecting-drawee bank gives a credit in payment of a check the relation of debtor-creditor is substituted for that of agency) that these were cash letter cases. Merchandise draws most of these inferences from the fact that the banks involved gave their respective depositors provisional credits upon the deposit of the checks. It is true that it was stipulated that the practice of banks was that when such a credit is given a cash letter is used (IV, 1186); but it cannot be assumed that this practice was invariably employed. None of the cases so cited by Bank of America said that a cash letter was used; and for all we know some other method of communication may have been used. But the fact that none of these cases mentioned the means by which its check was transmitted is certainly significant; it shows that none of them considered

the fact that a cash letter was used, if one was used, of any importance.

3. Merchandise says that Bank of America's reciprocal accounts cases are not applicable because there were not reciprocal accounts in this case (MB, 90). We presume that the remark is based on Merchandise's preposterous check stub analogy (supra pp. 32-33). This case is a case of reciprocal accounts (OB, 37-38).

4. Merchandise states that there are not reciprocal accounts until entries are made on the books of both banks, a credit on one side and a debit on the other (MB, 90). This confuses the making of the entries with the accounts. Reciprocal accounts exist when a charge or credit on one side is automatically a credit or charge on the other, whether or not entries are made (OB, 37-38). And the cases lend this contention of Merchandise's no support whatever. In *First National Bank of Corsicana v. Wm. Cameron & Co.*, 149 S.W. (2d) 132 (cited on page 34 of our opening brief), the forwarding bank had an account with the collecting-drawee bank. The court held that when the Corsicana Bank (the collecting-drawee bank) charged the account of the drawer and credited the account of the Blooming Grove Bank (the forwarding bank) "the Corsicana bank then ceased to be the agent either of plaintiff [payee of check] or of the Blooming Grove bank, but from that time on the Corsicana bank was a debtor of the Blooming Grove bank, which was in turn a debtor of plaintiff." In another of our cases, *Rickey v. New York State National*

Bank, 7 F. Supp. 29 (to which we have already referred and which is cited on page 33 of our opening brief), the collecting-drawee bank had an account with the forwarding bank, and the conclusion was just the same as that reached in the *Corsicana* case.

When the collecting-drawee bank becomes the owner of the funds and gives the credit, the change in the relationship takes place, whether the collecting-drawee bank maintains an account with the forwarding bank, or vice versa.

5. Now let us consider the cases on which Merchandise relies in this connection.

People v. People's Bank of Rockford, 353 Ill. 280, 187 N.E. 522 (MB 81; the case is discussed on pages 31-32 of our opening brief), is a collect and remit case. There is nothing in the case in conflict with the later Illinois case of *People v. Sheridan Trust and Savings Bank,* 358 Ill. 290, 193 N.E. 186, a collect and credit case, on which Bank of America relies (OB, 34). And in the first of these two cases, *People v. People's Bank,* the court said:

> "We think it is clear that the forwarder of the check, in the absence of specific instructions to remit by the collecting bank's own check or draft, and in the absence of reciprocal accounts, as in this case, never intends to become a creditor of the paying bank or to extend to it any credit or trust."

When Bank of America instructed Merchandise by the collection letters to credit its account it manifested an intention to become a creditor of Merchandise

more unequivocally than if it had instructed Merchandise to remit by its own check.

Dakin v. Bayly, 290 U.S. 143, 54 S. Ct. 113, which is cited frequently by Merchandise (MB, 40; 58, 82, 91), is another collect and remit case. In it, the court said:

> "But here we have no credit extended by the St. Petersburg bank [the collecting-drawee bank] to the Clearwater bank [the forwarding bank] on the faith of the checks forwarded for collection and no mutual deposit accounts, but a mere agency evidenced by a collection letter requiring collection and remittance. The fact that no credit was extended to the forwarding bank by the collecting bank leaves it open to the depositor to assert his claim against the latter, * * *"

Krueger v. First National Bank, 217 Ill. App. 18 (MB, 39), involved a draft drawn on a milling company, not a check, and was still another collect and remit case.

6. Summing up: The cases cited by Bank of America fully support its contention that the checks were collected and paid when Merchandise charged the account of United and credited Bank of America and that Merchandise thereupon became the owner of the proceeds and indebted to Bank of America and Bank of America to Lofendo; and Merchandise's attempts to distinguish those cases are futile.

On the other hand the cases cited by Merchandise are not only not in conflict with those relied on by Bank of America, but do not support in any way

whatever Merchandise's claim that the checks were not collected and paid and there was no change in relationship until Bank of America made entries on its books changing Merchandise's account.

V. MERCHANDISE'S CONTENTION THAT BANK OF AMERICA HAD NO RIGHT OF SET OFF IS ERRONEOUS.

We argued this point on pages 45-54 of our opening brief.

After saying that a banker's lien is dependent on possession and that when a bank sends forward a check for collection it parts with its possession and loses its lien (MB, 52-53), Merchandise accepts the ruling of the *Kane* and *Goggin* cases which is exactly to the contrary (MB, 54).[19]

Then Merchandise without argument lays it down that as Lofendo was not indebted to Bank of America when Bank of America sent the checks forward for collection,[20] it cannot be considered a holder in due course of a lien on the proceeds under section 3108 of the California Civil Code (MB, 54-55). We submit that our argument to the contrary (OB, 51-52), which Merchandise ignores, is sound.

In our opening brief, we argued that assuming that Bank of America did not become a holder for value

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[19]These cases are cited and discussed on pages 46-48 of our opening brief.

[20]It will be recalled that the Branch sent the four checks forward on November 10th; that Merchandise paid them on the 12th; that the Branch sent the six checks forward on the 13th; that Merchandise paid them on the 15th; and that Lofendo did not become indebted to the Branch until November 16th.

under section 3108, nevertheless it did become a bona fide purchaser of its right of setoff against Lofendo; and therefore Merchandise is not entitled to recover the payments (OB, 51-53).

Merchandise's answer is based on its basic misconception, that is that the checks were not collected and paid until Bank of America made book entries charging Merchandise's account; that it owed nothing to Bank of America until these book entries were made; and that when on November 19th, they were made, Bank of America had notice of Merchandise's claim that the checks had been paid by mistake (MB, 54-55).

The elementary rules are that when a bank pays a check of a depositor, the depositor becomes indebted to it in the amount of the payment, but the bank when paying the check immediately acquires the right to offset such indebtedness of its depositor to it against any credits to which he is entitled. 9 C.J.S. 556-561, sec. 273.

When on November 12th and 15th Merchandise paid the checks by crediting Bank of America, it thereupon became indebted to Bank of America and Bank of America to Lofendo; that is on those days Lofendo became entitled to the credits; and when on November 16th Bank of America paid the checks for $109,569.16 and $75,586.86, Lofendo became indebted to it, and Bank of America thereupon became a bona fide purchaser of its right of setoff, that is its right to charge such payments against all the credits to which Lofendo was then entitled.

Merchandise says that the checks for $109,569.16 were charged against the account on November 16th before the advices of credit for the four checks were received on that day, and that the checks for $75,586.86 were paid by Bank of America's failure to reject them at the close of business on November 16th and that neither the checks for $109,569.16 or those for $75,586.86 were paid in reliance on the credit for the four checks for $89,813.16, or of the six checks for $113,216.50 (MB, 17-20).

Merchandise states in effect that Bank of America did not know until the evening of November 18th that it had charged the checks for $109,569.16 against uncollected funds represented by the checks for $97,207.00; that Bank of America did not know until the 17th that it had paid the checks for $75,586.86 by not rejecting them on the 16th; and that although it knew on November 16th that Merchandise had given it credit for the four checks (the advices of credit for the four checks were received by the Branch on that day), it did not know until later that Merchandise had given it credit for the six checks.[21] Merchandise then claims in effect that as Bank of America did not have knowledge of these things on November 16th, it cannot be regarded as a bona fide purchaser of its right of setoff (MB, 73).

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[21] It will be recalled that the advice of credit for the six checks was mailed by mistake to the head office of Bank of America where it was received on the 18th and that it was then mailed by the head office to the Branch where it was received on November 19th.

But Lofendo's right to the credits did not depend upon whether some particular officer or clerk in the Branch was aware of the fact that Merchandise had granted the credits; and Bank of America's right to charge the checks for $109,569.15 and $75,586.86 against the credits did not depend upon whether some particular officer or clerk was aware of the fact that it had paid these checks, nor upon whether it paid the checks in reliance on the credits. Its rights depended upon the facts, upon the existence of the credits and upon the making of the payments; not upon the awareness of some officer or clerk of these facts. Lofendo was entitled to the credits; Bank of America had paid the checks. Its right to setoff depended on these facts and on nothing else.

Furthermore, these contentions of Merchandise's counsel show a fundamental misconception of the banking business. Take, for example, the Branch of Bank of America involved in this litigation. It had deposits of $20,000,000.00 (I, 392); it by itself was carrying on a big business. Every day checks were pouring into it in large numbers. It was called upon by the law and by the clearing house rules to make rapid decisions with respect to the payment of checks. The Branch, like every other bank, in paying checks of any depositor, relied not only on the credits to which he was entitled then appearing on its books, but all credits to which he was entitled; in other words, on its right of offset. This right does not depend upon whether an officer or clerk happens to know of its existence; but upon the fact that it

does exist. A bank should be given the same treatment so far as its rights are concerned as it is given so far as its liabilities are concerned. A bank becomes liable whether or not an officer or clerk happens to know what is taking place. For example, Bank of America became liable to pay the checks for $75,586.86 by not rejecting them in time without regard to whether an officer or clerk knew it was assuming this liability. And a bank becomes entitled to the right of offset or any other right allowed it by the law whether or not an officer or clerk happens to be aware of its existence.

Suppose in the case of a branch bank like Bank of America a depositor has a credit in one branch, but is indebted to another branch; would it not be absurd to suggest that the bank does not have its right of offset because the branch to which the depositor is indebted does not know of the credit to which he is entitled in the other branch?

There can be no doubt whatever that at the close of business on November 16th Bank of America had the right to charge the checks for $109,569.16 and $75,586.86 against the credits for the four and six checks; that it was a bona fide purchaser of this right of setoff; and that Merchandise cannot deprive Bank of America of it.

Merchandise also says that it "never paid any sum to the defendant for the purpose of discharging any debt that Lofendo may have owed defendant" (MB, 72). Of course, its clerks who handled the payment of the checks had no such purpose. But Merchandise

was charged with the knowledge that when it paid Bank of America the amount of the checks, Bank of America would have the right to offset the proceeds against any indebtedness Lofendo might happen to owe it.

VI. MERCHANDISE CANNOT RECOVER FROM BANK OF AMERICA ITS PAYMENT OF THE FOUR AND SIX CHECKS BECAUSE IT RECEIVED A SUBSTANTIAL BENEFIT FROM THEIR PAYMENT.

We argued this point on pages 54-56 of our opening brief; and Merchandise answered it on pages 112-116 of its brief.

$161,431.51 of the checks for $185,156.01 (the $109,-569.15 plus the $75,586.86) was paid to Merchandise and was applied by it on United's indebtedness to it. Merchandise got the benefit of this $161,431.51.

Merchandise's verbose argument cannot change the fact that it would be inequitable for it to receive the benefit of Bank of America's payment of the checks for $185,156.01 and yet prevent Bank of America from offsetting these payments against the credit to which Lofendo was entitled by virtue of Merchandise's payment of the four and six checks. Under the law the fact that its position is tainted by this inequity precludes a recovery by it.

VII. BANK OF AMERICA'S POSITION WAS CHANGED BY REASON OF MERCHANDISE'S PAYMENT OF THE FOUR CHECKS AND THEREFORE IT BECAME A BONA FIDE PURCHASER OF THEIR PAYMENT.

We argued this point on pages 58-69 of our opening brief.

1. Merchandise's principal contention so far as this point is concerned is that under the rule of the *Weiner* case Bank of America is not entitled to keep Merchandise's payment of the four checks because it retained such payment as Lofendo's agent until on November 19th it made a book entry charging it against Merchandise's account with it and that at the time it had notice of the claim that the checks were paid by mistake (MB, 20; 76).

This is just another illustration of Merchandise's fundamental fallacy that the checks were not collected and paid until Bank of America made an entry on its books charging them against Merchandise's account and that until such entry was made there was no change in relationship from agency to debtor-creditor. As Merchandise paid the four checks when it on November 12th gave Bank of America credit, and as on that date the agency was terminated and Merchandise became indebted to Bank of America in the amount of the checks, the date on which Bank of America made book entries on Merchandise's account with it is totally irrelevant.

2. However, Merchandise also contends in effect that assuming that Merchandise paid the checks on November 12th, nevertheless under the rule of the

Weiner case Bank of America is not entitled to retain the payment because it did not make "actual application" of the credit by posting it and the charge against it in its books until after it received notice by the Messenger-Estribou conversation of November 17th that Merchandise was claiming that it had paid the six checks by mistake (MB, 16-17; 20-21; 73-74).

(a) As established by our point V, Bank of America is entitled to its right of setoff whether or not the *Weiner* case is applicable.

But assuming for the sake of the argument that the case is to be governed by the rule of the *Weiner* case, nevertheless Merchandise cannot recover.

As pointed out on pages 64-67 of our opening brief, where the intention is that any payment received by an agent for the account of his principal shall *ipso facto* be charged against any indebtedness of the agent to the principal, then under the rule of the *Weiner* case the agent is not required actually to make the bookkeeping entry charging the principal's account in order to become a bona fide purchaser of the payment, but he becomes such upon receiving it whether or not he makes the entry on his books. The intention of the parties, the facts, must control, not the purely fortuitous circumstances whether or not a clerk of the agent has made a bookkeeping entry.

But as when Merchandise paid the four checks on November 12th Bank of America ceased to be Lofendo's agent and became his debtor in the amount of the checks, the situation becomes even clearer.

Then by virtue of the bank-depositor relationship, the credit to his account to which Lofendo then became entitled was offset by the debits thereto created by Bank of America's payment of the checks for $109,-569.15 and $75,586.86; and this would have been the result whether or not any bookkeeping entries had been made.

(b) But if it be assumed that under the rule of the *Weiner* case Bank of America could not become a bona fide purchaser of the payment of the four checks unless it prior to the Messenger-Estribou conversation of November 17th actually took action in reliance on the advice of credit for the four checks, the stipulated facts in the record show that it took such action by putting the checks for the $75,586.86 in the counter work and crediting the account with the $89,813.10, all on November 17th. See pages 60-67 of our opening brief.

Merchandise claims that LeRoy's testimony that Duncan told him in their conversation of November 18th that Estribou had said that there was a balance of $690.00 odd in the account shows that the $89,813.10 was not credited to the account on November 17th (MB, 20-21). LeRoy testified that Duncan told him this after Duncan's first conversation with Estribou in the morning of the 18th (II, 452-455). But there is nothing inconsistent between the stipulation that the $89,813.10 was credited to the account on November 17th (IV, 1182; 1183) and this hearsay on which Merchandise relies. When on the morning of Novem-

ber 18th Estribou was talking with Duncan, he doubtless had before him the ledger sheet of the account before the credit had been posted and which, therefore, showed the balance of $699.02. But in any case the stipulation that on November 17th the checks for $75,586.86 were put in the counter work and that on that day the account was credited with the $89,813.10 must control.[22]

3. There can be no doubt that under the rule of the *Weiner* case Bank of America became a bona fide purchaser of Merchandise's payment of the four checks.

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[22]Merchandise says that Messenger in his conversation with Estribou of November 17th assumed that Bank of America had already paid out funds and changed its position in reliance on the $89,813.10 advice of credit, and that consequently Merchandise did not mention this advice of credit then or in the conversations of November 18th (MB, 23-24). And it also says that "Before telephoning, Mr. Messenger had been told by plaintiff's general counsel that an advice of credit could be revoked if not acted on" (MB, footnote 24).

This is an incorrect statement of the testimony. Messenger testified on cross-examination that prior to his conversation with Estribou his counsel had told him that his opinion was that "if the advice of credit [the advice for the six checks] had not been received by the Bank of America, we would rescind our credit" (I, 257).

It would have been most extraordinary if the opinion of Merchandise's counsel on November 17th given on the spur of the moment when Merchandise had just discovered that something was wrong in the United account and before any controversy with Bank of America had arisen should have corresponded to the technical, abstruse and erroneous views developed by Merchandise's counsel during the course of this litigation.

VIII. BANK OF AMERICA'S POSITION WAS CHANGED BY REASON OF MERCHANDISE'S PAYMENT OF THE SIX CHECKS AND THEREFORE IT BECAME A BONA FIDE PURCHASER OF THEIR PAYMENT.

We argued this point on pages 69-72 of our opening brief.

We make the same answers to Merchandise's claims respecting it as our answers to its claims respecting the four checks except that it is true (1) that Messenger told Estribou that Merchandise was claiming that it had paid the six checks in error, and (2) that Bank of America did not act upon the advice of credit for the six checks until after the Messenger-Estribou conversation.

Stated briefly, our position is this: If Bank of America's agency for Lofendo had continued after Merchandise's payment of the six checks on November 15th, and if therefore the rule of the *Weiner* case were directly applicable, then the credit to the account created by the payment would have offset automatically the debits to the account created by the payment of the checks. The undoubted intention of Lofendo and Bank of America that all credits should be offset by debits would have to be given effect whether or not bookkeeping entries were made. But as Bank of America's agency for Lofendo for the collection of the checks was terminated by their payment, and as at that time a creditor-debtor relationship between them was established, any doubt respecting the point is obviated—the debits were *ipso facto* offset by the credit. And so Bank of America's position was changed by the payment of the six checks, and it became a bona fide purchaser of the payment.

IX. MERCHANDISE IS PRECLUDED FROM RECOVERING THE PAYMENT (1) BECAUSE IT WAS NEGLIGENT IN MAKING THE PAYMENTS, AND (2) BECAUSE SUCH NEGLIGENCE WILL CAUSE BANK OF AMERICA PREJUDICE IF MERCHANDISE IS ALLOWED TO RECOVER.

We argued this point on pages 102-107 of our opening brief.

As the trial court did not find respecting the issue whether Merchandise was negligent, it must be assumed, so far as this point is concerned, that it was negligent (OB, 72-73). But so that this court could have the picture we reviewed the uncontradicted evidence showing that the manner in which Merchandise conducted its account with United was so astounding, so flagrantly bad, that one can infer that one or more of its officers or employees knowingly permitted the kite to continue (OB, 75-89). Merchandise says that it will not consider our discussion of this evidence because the issue is irrelevant (MB, 107).

1. Merchandise's claim that its negligence is irrelevant because under the law a payor is not precluded by his negligence from recovering a payment made by mistake.

Merchandise says that Bank of America argues that a payor cannot recover on the ground of mistake, if the mistake was due to his negligence; and that "this is not the law" (MB, 70).

Now Bank of America did not make the statement which Merchandise says it made. On the contrary, Bank of America stated that the authorities cited by it laid down the rule that "if the mistake inducing the payment was due to the negligence of the payor, and *if its recovery will cause prejudice,* the payor

cannot recover" (OB, 103-104). Bank of America made it clear that under the law the two elements must concur: negligence of the payor and prejudice to the payee. Merchandise in saying that Bank of America contended that negligence alone will bar recovery entirely misstates Bank of America's position.

2. Merchandise's contention that its negligence did not cause Bank of America prejudice.

Merchandise's mistake consisted in paying the four and six checks in the belief that the Lofendo remittance checks were bona fide when in fact they were part of the kite. Its mistake was certainly due to its gross negligence.

But Merchandise says that its negligence in not discovering the kite did not cause Bank of America any prejudice; that Bank of America suffered the loss which it will suffer if Merchandise recovers in this case because it gave Lofendo immediate credit for the checks for $97,207.00 against which the checks for $109,569.15 were charged and that it paid the checks for $75,586.86 by not rejecting them in time (MB, 112-113). The answer is that if all these checks had been bona fide and not part of the kite, Bank of America would have suffered no loss in paying the checks for $109,569.15 and $75,586.86. The kite will cause Bank of America its loss if Merchandise is allowed to recover; just as the kite will cause Merchandise the loss if it fails to recover. Merchandise is perfectly willing to say that its mistake in making the payments was due to the kite. It is perfectly will-

ing to say that Bank of America was negligent in permitting the kite to go on. But it does not want to talk at all about its own negligence; it wants to shun all discussion of its responsibility for the continuance of the kite. But it cannot shun this responsibility. Its behavior in allowing the kite to continue is a vital part of this case.

These facts are indubitable: (1) that Merchandise's mistake in making the payments was due to the kite and the continuance of the kite was due to its negligence; (2) if Merchandise is allowed to recover, Bank of America will suffer prejudice because of the kite to the tune of $174,192.34 plus interest.

It follows that under the law Merchandise cannot recover, and that this is so regardless of all the other points involved in this case.

3. Merchandise's claim that Bank of America's contention based on Merchandise's negligence is a counterclaim.

Merchandise also argues that Bank of America's contention that Merchandise's negligence precludes its recovery is not a defense, but a counterclaim, that is, a claim by Bank of America to recover damages from Merchandise because of its negligence in permitting the kite to continue; that Merchandise owed Bank of America no duty to exercise care to prevent the kite; that, therefore, Bank of America cannot recover on its counterclaim; and that consequently Merchandise's negligence is irrelevant and the trial court was not obliged to find with respect to it (MB, 35; 99-103; 104-107).

But so far as the point under discussion is concerned, Bank of America is not seeking to recover damages for Merchandise's negligence. It is seeking to prevent Merchandise from recovering its payments on the ground that under the law a payor cannot recover a payment made by mistake arising out of its negligence when such negligence will cause the payee prejudice if a recovery is allowed. The contention, therefore, is a defense, not a counterclaim.

4. Merchandise's contention that Bank of America was guilty of contributory negligence.

Merchandise says that if Bank of America were attempting to recover damages from Merchandise for its negligence, Bank of America would be precluded from recovering because of its contributory negligence (MB, 103-104).

Strangely enough the trial court made a finding that Bank of America was negligent, but refused to find with respect to Merchandise's negligence. As Merchandise is seeking to maintain what is in substance an equitable action to recover money paid by mistake, its negligence is certainly more relevant than the alleged negligence of Bank of America.

As pointed out on pages 89-95 of our opening brief, the trial court's finding that Bank of America was negligent is not supported by the evidence.

But as this claim of Bank of America is a defense, not a counterclaim for damages for negligence, the rule relating to contributory negligence is irrelevant. The rule which is applicable is the rule that "where

one of two innocent parties must suffer, the burden should be borne by the one whose action was the primary cause of the loss" (OB, 105-106). There cannot be any doubt whatever which of these two banks was the primary cause of the loss; it was Merchandise (OB, 106).

Furthermore, *Wells Fargo Bank v. Bank of Italy*, 214 Cal. 156, 163, 4 P. (2d) 781, 784, states the equitable maxim as follows:

> "* * * where the parties are equally innocent the law will leave the loss where they have placed it."

Section 3524 of the *California Civil Code* provides:

> "Between those who are equally in the right, or equally in the wrong, the law does not interpose."

To sustain the position of plaintiff, Merchandise, this Court must interpose to require a repayment by Bank of America of money paid by Merchandise. If we make the totally unjustified assumption that Merchandise was just as innocent as and no more at fault than the Bank of America, the law will leave the loss where it finds it and will not shift it from one of them to the other.

5. Merchandise's contention respecting its wire of October 22nd and letter of September 22nd.

Merchandise says that it did not by this wire and letter misrepresent to Bank of America United's credit and standing, and that Bank of America did not rely upon them in paying Lofendo's checks (MB, 110-112).

No amount of sophistry can disguise the facts that the wire and letter were representations that United was worthy of credit and was conducting its business on sound lines; that the representations were false; and that Bank of America relied on them (OB, 93-99).

X. THE TRIAL COURT ERRED IN NOT FINDING WITH RESPECT TO THE ISSUE WHETHER MERCHANDISE WAS PARTICIPATING IN UNITED'S FRAUD.

We made this point on pages 107-108 of our opening brief.

Merchandise's reply to it is that Bank of America's "pleadings made no such absurd charge that plaintiff conspired with United to defraud defendant" (MB, 108).

Bank of America's second separate defense and counterclaim alleges that United and Lofendo by carrying on the check kiting were fraudulently representing to Bank of America that the checks used in the kite represented bona fide payments, whereas such checks were fictitious; that United and Lofendo made these representations to Bank of America to induce it to pay Lofendo checks; that if Merchandise is permitted to recover Lofendo's account will be overdrawn; that in that event Bank of America will have been induced to extend credit to Lofendo in the amount of such overdraft by such fraud of Lofendo and United (I, 38-39); and then it alleges:

> "If as defendant is informed and believes, plaintiff about October 1, 1948, had knowledge

> of said check kiting and did not put a stop to it, plaintiff from that time to November 17, 1948, when said check kiting came to an end was in effect participating in said fraud perpetrated on defendant by United Produce Company and Lofendo" (I, 45).

Merchandise says that "There is not a scrap of evidence to support a claim that plaintiff was a co-conspirator with United" (MB, 108). The answer is that one cannot read the astounding facts disclosed by this record (OB, 74-87) without inferring that at least one of the officers or employees of Merchandise knew that United was engaged in a kite and permitted it to go on. And under elementary principles (OB, 107), if one such officer or employee with knowledge permitted the kite to go on, Merchandise as alleged in Bank of America's pleadings, was in effect participating in the fraud and became liable for whatever damages Bank of America may have suffered because of it.

XI. THE TRIAL COURT'S FINDING THAT BANK OF AMERICA ENTERED INTO A CONTRACT THAT IT WOULD NOT ACT UPON THE ADVICE OF CREDIT WITH RESPECT TO THE SIX CHECKS WHEN RECEIVED IS NOT SUPPORTED BY THE EVIDENCE, BUT SUCH AGREEMENT, IF MADE, WAS VOID AND UNENFORCEABLE.

1. The findings are not supported by the evidence.

We discussed this point on pages 108-117 of our opening brief.

Merchandise's reply is the arbitrary assertion that the evidence stated in our opening brief supports the finding (MB, 60).

We submit that the evidence shows no intention of the officers engaged in the conversations to enter into a contract, but only a willingness of Bank of America to follow instructions being given it by Merchandise on the basis that Merchandise had sent out the advice of credit by error and was therefore rescinding it.

2. Assuming a contract, it was invalid because not supported by a consideration.

We discussed this point on pages 117-118 of our opening brief.

Merchandise's answer is that "if obligations arose on November 15th, as defendant claims, the mutual release of those obligations was consideration, each for the other" (MB, 60). This obscure statement means that if when Merchandise granted the credit for the six checks on November 15th Merchandise became indebted to Bank of America, it could only be because Bank of America had assumed Merchandise's obligation to Lofendo in consideration of Merchandise's agreement to pay Bank of America (Merchandise makes a detailed statement of this contention on pages 35 and 56-57 of its brief); and that the alleged agreement by Bank of America to release Merchandise from its liability to Bank of America was supported by Merchandise's agreement to release Bank of America from the latter's agreement to assume Merchandise's obligation to Lofendo.

Bank of America denies that Merchandise, when it gave its credit to Bank of America, was under any obligation to Lofendo; and denies that Bank of America ever assumed any such obligation of Merchandise to Lofendo. And Merchandise denies that Bank of America made any such agreement (MB, 59). Obviously a hypothetical agreement which both parties say was not made could not possibly be a consideration for the alleged contract of Bank of America to release Merchandise from its liability created by the credit.

But Merchandise's suggestion that it upon the granting of the credit might have assumed an obligation to Lofendo and Bank of America might have agreed to assume such obligation to Lofendo is based upon the same basic fallacy which vitiates Merchandise's other arguments.

When Bank of America as Lofendo's agent for the collection of the checks instructed Merchandise, as it was authorized to do by section 16c, to pay the checks by granting the credit and when Merchandise pursuant to these instructions granted the credit the checks were collected and paid as though Merchandise had paid cash to Bank of America (supra pp. 17 to 28); and when these acts took place, Merchandise did not undertake any obligation to Lofendo and Bank of America did not agree to assume any obligation of Merchandise to Lofendo. And so Bank of America's alleged contract to release Merchandise from Merchandise's indebtedness to it created by the credit cannot be supported by Merchandise's agree-

ment to release Bank of America from an agreement Bank of America never made (that is an agreement by Bank of America to assume Merchandise's alleged obligation to Lofendo).

In *Bard v. Kent,* 19 Cal. (2d) 449, 122 P. (2d) 8, the court, in holding that the payment by a lessee of architect's fees for plans relating to improvements to the premises was not a consideration for an agreement of the lessor giving the lessee an option to extend the lease said:

> "There is no doubt that such payment would be consideration for an option if the offeror agreed to accept it as such (citing cases). No act of an offeree, however, can constitute consideration binding upon the offeror unless the latter agrees to be bound in return therefor (citing cases). In the words of the Restatement of Contracts (Sec. 75): 'Consideration must actually be bargained for as the exchange for the promise * * * The fact that the promisee relies on the promise to his injury, or the promisor gains some advantage therefrom, does not establish consideration without the element of bargain or agreed exchange.' "

In *Fire Insurance Association v. Wickham,* 141 U.S. 564, 12 S. Ct. 84, the court, in holding that the repayment of losses by insurance companies was not a consideration for an agreement by the insured to accept less than the amount due him, said:

> "* * * That prepayment of part of a claim may be a good consideration for the release of the residue is not disputed; but it is subject

> to the qualification that nothing can be treated as a consideration that is not intended as such by the parties. * * * To constitute a valid agreement there must be a meeting of minds upon every feature and element of such agreement, of which the consideration is one. The mere presence of some incident to a contract which might, under certain circumstances, be upheld as a consideration for a promise, does not necessarily make it the consideration for the promise in that contract. To give it that effect, it must have been offered by one party, and accepted by the other, as one element of the contract."

See, also, *Williams v. Hasshagen,* 166 Cal. 386, 137 P. 9; *In re Dutton's Estate,* 37 A. 583, 181 Penn. 426; *Yuma National Bank v. Balsz,* 237 Pac. 198, 28 Ariz. 336; and *Restatement, Contracts,* sec. 74, pp. 81, 82.

If we make the totally unjustified assumption that the effect of the alleged agreement arising out of the conversations of November 17th and 18th was to release Bank of America from its supposed agreement to assume Merchandise's supposed obligation to Lofendo, still such release of Bank of America cannot be considered consideration for Bank of America's alleged release of Merchandise from its liability created by the credit because such release of Bank of America was not bargained for as the exchange for its alleged promise; that is there can be no pretense that it was offered by Merchandise and accepted by Bank of America as consideration for the latter's alleged promise.

3. Assuming a contract, it was invalid because based on mistake.

We argued this point on pages 118-119 of our opening brief.

Merchandise's answer is that the "impression" of Bank of America's officers when the conversations of November 17th and 18th took place that there was a black balance in Lofendo's account "was not based on anything said by plaintiff," and that no mistake justifying the rescission of the agreement was made because the officers of Bank of America knew that the Branch might not be in the clear and were doubtful of Bank of America's position but made the agreement anyway (MB, 61-62).

It makes no difference that the belief of the officers of Bank of America that there was a good balance in the account was not based on anything said by Merchandise. A party may base his rescission on a mistake made by him alone; there is no requirement that the mistake be mutual or that it be induced by the representation of the other party. *California Civil Code,* Sec. 1577; *Palace Hardware v. Smith,* 134 Cal. 381, 384, 66 P. 474, 476; *Lepper v. Ratterree,* 98 Cal. App. 245, 255, 276 P. 1037, 1041. Furthermore, the mistake in this case was mutual because Merchandise was told that there was a credit balance in the Lofendo account.

And the record shows conclusively that all the men involved in the transaction believed that there was a good balance in the account (OB, 118-119).

It is true that Duncan testified that after Johnson had finished his telephone conversation with Estribou, he reported to Duncan and LeRoy that "everything was in the clear and it looked perfectly all right;" and that Johnson also said that Estribou had stated that although the account looked in the clear at the moment, "there were so many items in transit that anything could happen" (II, 549).

The items in transit to which Duncan referred were checks drawn by Lofendo on the account, not checks which had been credited to the account and were uncollected. Checks in transit drawn by Lofendo on the account could not put it in the red unless paid by the Branch; and certainly Estribou did not contemplate that the Branch would pay checks drawn on the account if there were not sufficient funds in the account to pay them. Estribou believed, as he told Messenger, that the Branch had not been paying against uncollected funds (I, 374). And when on November 18th Duncan, after the conclusion of his conferences with LeRoy, wrote Estribou his letter of that date he congratulated Estribou for keeping his Branch in the clear (Plaintiff's Exhibit 11; IV, 1174a). In the light of this letter it cannot be suggested that Johnson's statement to Duncan respecting what Estribou had said concerning items in transit raised any doubt in Duncan's mind whether the Branch was in the clear.

Furthermore, it is impossible to believe that the Bank of America officers would have consented that

Merchandise could rescind the credit if they had not believed that there was a credit balance in Lofendo's account. No one can think for a moment that they were prepared to give Merchandise a large sum of their bank's funds.

The authorities cited by Merchandise (MB, 62) are not in point. In *Cleveland-Cliffs Iron Co. v. East Itasca Mining Co.*, 146 Fed. 232, the court held that the plaintiff could not recover payments made by it to defendant for an assignment of two mining leases on the ground that the ore was not up to the standard indicated by its previous tests and that therefore the amount it paid was excessive. In *McGregor v. Millar,* 166 Kan. 657, 203 P. (2d) 137, 140, the court held that the plaintiff could not recover a payment made by him to settle a controverted claim when he discovered later that the facts were not what he believed them to be. In the case at bar, Bank of America is not seeking to recover a payment made by it in purchasing property of doubtful value or made by it to settle a claim; but it is seeking to avoid an alleged contract on the ground that its alleged consent thereto was induced by a mistake respecting a material fact.

Merchandise's contention (MB, 62; footnote 28) that Bank of America's mistake was not material, that it did not go to the substance of the transaction, is fully answered by what we said on pages 120-121 of our opening brief and the case there cited, *Hannah v.*

Steinman, 159 Cal. 142, 146-149, 112 P. 1094, 1096-1097.[23]

4. Assuming a contract, it was induced by Merchandise's fraud.

We argued this point on pages 121-123 of our opening brief.

Merchandise says that the representations of Messenger and LeRoy that the advice of credit had been sent out in error, that a clerk had mailed it by mistake, were true (MB, 63). They were not (OB, 121).

Merchandise also says that LeRoy told Duncan "that plaintiff had discovered a kite and informed him of the very occurrences which defendant now relies on as showing such negligence" (MB, 63). LeRoy testified that he told Duncan that Merchandise had "uncovered a large scale kiting operation" (II, 543 and 547) and that Merchandise upon checking United's books had obtained a satisfactory answer to its questions (II, 634); but he did not state or suggest to Duncan any of the facts showing that Merchandise by the grossest sort of negligence had permitted the kite to continue. To suggest that he did is simply not true. He implied to Duncan just the opposite (II, 634).

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[23]The *Hannah* case was followed in several later cases, including *Alberti v. Jubb*, 204 Cal. 325, 328, 267 P. 1085, 1087; *Security Trust and Savings Bank v. Southern Pacific Co.*, 214 Cal. 81, 85, 3 P. (2d) 1015, 1017, and *Estate of Barton,* 96 Cal. App. (2d) 234, 239, 214 P. (2d) 857-860.

XII. MERCHANDISE'S CONTENTION, THAT AS UNITED COULD NOT COMPEL MERCHANDISE TO PAY UNITED'S CHECKS BANK OF AMERICA CANNOT RETAIN THEM, IS ENTIRELY IRRELEVANT.

Merchandise maintains that as United was using the Lofendo account to carry on the kite and as United by carrying on the kite by means of the Lofendo remittance checks was fraudulently inducing Merchandise to make it loans and pay its checks, Merchandise could recover from United payments made to it on account of its checks; and then Merchandise asserts repeatedly that it can recover its payments of the four and six checks from Bank of America because Bank of America had no better rights than United (MB, 4-6; 31; 41; 47; 49-50).

The argument is entirely irrelevant. Merchandise cannot recover the payments from Bank of America for the reasons stated in our opening brief and this brief. Bank of America stands on its own rights, rights that are certainly different from any that could be asserted by Lofendo and United and not derived in any way from them.

XIII. MERCHANDISE'S CHARGES AGAINST BANK OF AMERICA ARE ENTIRELY UNWARRANTED AND UNTRUE.

1. Merchandise asserts that Bank of America "decided" to charge Merchandise's account with it with the $89,813.10 after learning on November 18th that the checks for $97,207.00 had been rejected; it says that Bank of America made this charge with "crass motives" and surreptitiously (MB, 18-20; 24-25).

The putting on November 17th of the checks for $75,586.86 into the work and the crediting of the account with the $89,813.10 (Plaintiff's Exhibit 14; IV, 1182-1183) took place before the Branch learned late in the evening of November 18th that Merchandise had rejected the checks for $97,207.00. The making of the entries at Bank of America's head office charging Merchandise's account followed as a matter of course. These acts would have taken place just as they did take place if no controversy of any sort had arisen.

And so Merchandise's assertion, that Bank of America did not decide to enter the charge until it learned of the rejection of the checks for $97,207.00 and that when it did make the entry it was acting with improper motives and in an improper manner, is just pure and simple hokum.

2. And so is its charge that Bank of America in crediting Lofendo's account with the amount of the six checks and charging the checks for $97,207.00 was acting with the "crassest motives" and seeking to "rob" Merchandise (MB, 10-11). Accepting as true Messenger's testimony, still he admitted that Estribou's willingness to follow his instructions, that the advice was rescinded and not to enter the credit, was based on Estribou's mistaken belief that the branch had not been paying against uncollected funds and that the account was in the black. When Bank of America discovered its mistake it certainly had the legal right, and also the moral right, to change its mind. It is preposterous to say that it was robbing Merchandise by

doing so. The shoe is on the other foot. When Merchandise seeks, as it is doing, to take advantage of Bank of America's mistake, its moral position is indefensible. And it should not be forgotten that it by its own gross negligence permitted the kite to continue and by falsely representing United's credit and standing induced Bank of America to continue to pay Lofendo checks.

XIV. CONCLUSION.

No matter how Merchandise attempts to disguise the fact, it is nevertheless true that it is attempting to recover from Bank of America part of the loss which it brought upon itself by permitting the kite to continue.

It has neither the moral nor the legal right to recover.

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